

Internal Revenue Service

Department of the Treasury
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Date: September 5, 2007

X =

Date 1 =

Date 2 =

Date 3 =

Y =

A =

B =

C =

m =

n =

o =

Dear :

This responds to a letter dated June 12, 2007, submitted on behalf of X, requesting a ruling under section 1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X elected to be taxed as an S corporation effective Date 1. On Date 2, a portion of the stock of X was transferred to Y, a partnership and an ineligible shareholder. Effective Date 3, the stock of X held by Y was transferred to A, B, and C as follows: m shares to A, n shares to B, and o shares to C. A, B, and C were eligible shareholders.

X and its shareholders represent that they were unaware of the fact that Y was an ineligible shareholder and did not intend the S election of X to terminate. Immediately after they discovered the termination, they took remedial action to rectify the error. X and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of X as an S corporation.

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under section 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in section 1361(c)(2), or an organization described in section 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1362(f) provides, in relevant part, that if (1) an election under section 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to section 1362(b)(2)) by reason of a failure to meet the requirements of section 1361 (b) or to obtain shareholder consents, (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in ineffectiveness, steps were taken so that the corporation is once more a small business corporation, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to section 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in the ineffectiveness, the

corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the facts submitted and the representations made, we conclude that X's election to be an S corporation terminated on Date 2 when a portion of the stock of X was transferred to Y. We further conclude, however, that the termination was an inadvertent termination within the meaning of section 1362(f). Therefore, pursuant to the provisions of section 1362(f), X will be treated as continuing to be an S corporation on and after Date 2, unless X's S election otherwise terminated under section 1362(d).

Accordingly, X and its shareholders who were shareholders during the termination period must include the pro-rata share of the separately and nonseparately computed items attributable to those shares in their income as provided in section 1366, make adjustments to the stock basis of those shares as provided in section 1367, and take into account any distributions with respect to those shares as provided in section 1368. Also during this period from Date 2 to Date 3, the shares of X held by Y must be treated as owned directly by A, B and C. This ruling is contingent on X and X's shareholders filing amended returns consistent with this paragraph.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed concerning whether X is otherwise eligible to be treated as an S corporation or whether Trust is eligible to be treated as a QSST.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

David R. Haglund
Senior Technician Reviewer
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

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